



# STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

# DRAFT

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| Date Amended:  | 05/24/11          | Bill No:        | <a href="#">Assembly Bill 1007</a>     |
| Tax Program:   | Sales and Use Tax | Author:         | Cook                                   |
| Sponsor:       | Author            | Code Sections:  | RTC 6397                               |
| Related Bills: |                   | Effective Date: | Upon enactment, but operative 08/03/12 |

## BILL SUMMARY

This bill would provide a sales tax exemption on the sale of “qualified back-to-school product,” for \$100 or less, during a three-day period in August 2012, and every following year until January 1, 2016.

### Summary of Amendments

The amendments to this bill since the previous analysis clarify that the exemption period is a three-day period, add a repeal date of January 1, 2016, define “qualified back-to-school product,” and specify that the proposed exemption does not apply to the Bradley-Burns Uniform Local Sales and Use Tax Law or the Transaction and Use Tax Law.

## ANALYSIS

### CURRENT LAW

Under existing law, a sales tax is imposed on retailers for the privilege of selling tangible personal property at retail in this state. The use tax is imposed upon the storage, use, or other consumption of tangible personal property purchased in this state. Either the sales tax or the use tax applies with respect to all sales or purchases of tangible personal property, unless specifically exempted or excluded.

Under current law, sales of clothing and footwear, as well as school supply items and sports equipment, are generally subject to the sales or use tax to the same extent as any other sale of tangible personal property not otherwise exempted or excluded by statute. However, Revenue and Taxation Code Section 6375.5 of the Sales and Use Tax Law provides an exemption for sales of new children’s clothing when sold to a nonprofit organization for its distribution without charge to elementary school children.

Beginning July 1, 2011, the statewide sales and use tax rate (7.25%) imposed on taxable sales and purchases of tangible personal property is made up of the following components (additional transactions and use taxes (also known as district taxes) are levied by various local jurisdictions and are not reflected in this chart):

| Rate  | Jurisdiction                 | Purpose/Authority  |
|-------|------------------------------|--|
| 5.00% | State (General Fund)         | State general purposes (Revenue and Taxation Code (RTC) Sections 6051, 6051.3, 6201, and 6201.3) |
| 0.25% | State (Fiscal Recovery Fund) | Repayment of the Economic Recovery Bonds (RTC Sections 6051.5 and 6201.5, operative 7/1/04)      |

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| Rate  | Jurisdiction   | Purpose/Authority   |
|-------|--|---|
| 0.50% | State (Local Revenue Fund)                                   | Local governments to fund health and welfare programs (RTC Sections 6051.2 and 6201.2)                                    |
| 0.50% | State (Local Public Safety Fund)                             | Local governments to fund public safety services (Section 35, Article XIII, State Constitution)                           |
| 1.00% | Local (City/County)<br>0.75% City and County<br>0.25% County | City and county general operations (RTC Section 7203.1, operative 7/1/04);<br>Dedicated to county transportation purposes |
| 7.25% | Total Statewide Rate   |   |

The 1% General Fund tax under Sections 6051.7 and 6201.7 will expire on 6/30/11.

#### PROPOSED LAW

This bill would add Section 6397 to the Sales and Use Tax Law to provide a sales tax exemption for the sale of a “qualified back-to-school product” on an annual basis during a three day period in August, beginning at 12:01 a.m. on the first Friday of August 2012, and ending at 11:59 p.m. on the following Sunday of August 2012 (August 3 through 5, 2012).

This bill would provide that “qualified back-to-school product” includes the following products, if the gross receipts from the sale of that product are \$100 or less: backpacks (as specified); binders; blackboard chalk; book bags; calculators; cellophane tape; compasses; composition books; crayons; dividers; erasers; folders, as specified; geometry sets; glue, paste, or glue sticks; highlighters; index cards; lunch boxes; markers; notebooks; notepads; pencil boxes and other school supply boxes, pencils; pencil sharpeners; pens; protractors; rulers; scissors; student planners; and writing tablets.

This bill would require that the sale of qualified back-to-school products be made by the purchaser at the retailer’s physical place of business.

The exemption would *not* apply to any tax levied pursuant to Bradley-Burns Uniform Local Sales and Use Tax Law and Transactions and Use Tax Law.

This is an urgency bill and would take effect immediately, but would not be operative until the first Friday in August 2012.

#### BACKGROUND

This proposed law is modeled after a similar law in New York State. Sales of clothing and footwear are exempt from tax in New Jersey, and many residents of New York went to New Jersey to purchase their clothes. To help discourage this, New York State implemented a law in 1997 allowing for a one-week exemption from the tax for the sales of clothing valued under \$100. The State of New York continues to offer the sales tax exemption on clothing items, but due to budget concerns in that state, the exemption for clothing items costing less than \$110 was suspended from October 2010 to April 2011. Starting in April 1, 2011 the exemption will be reinstated but only for items costing below \$55. Then, beginning after March 31, 2012, the exemption for items priced less than \$110 will be reinstated in full.

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Currently, there are fifteen states that will have a sales tax holidays in effect in 2011 for the purchase of clothing, and/or school supplies, and/or computers during a specified period in August. These states include the following: Alabama, Connecticut, Iowa, Louisiana, Maryland, Mississippi, Missouri, New Mexico, New York, North Carolina, Oklahoma, South Carolina, Tennessee, Texas, and Virginia.

Minnesota, New Jersey, Pennsylvania and Rhode Island offer a limited year-round sales tax exemption on clothing.

California has had several “sales tax holiday” bills introduced over the years that would have provided a sales tax exemption for certain types of merchandise:

**Clothing and Footwear.** AB 1185 (Mountjoy, 2001) would have provided a partial sales tax exemption for clothing and footwear purchased for \$200 or less during a one-week period in August, starting in 2003, and continuing for the same one-week period for each year thereafter. AB 1185 was held under submission in Assembly Revenue and Taxation Committee.

AB 944 (Cardenas, 1999) would have provided a partial sales tax exemption for clothing and footwear purchased for \$100 or less during a 3-day period in August 2001. The bill was never heard in Senate Revenue and Taxation Committee.

**Clothing, Footwear, and Computers.** AB 548 (Garcia, 2005) would have provided a sales tax exemption for any article of clothing, clothing accessory, or footwear for \$100 or less, school supplies for \$500 or less, and personal computers and related accessories for \$1,000 or less, during a four day period in August 2006. The bill was held under submission in Assembly Revenue and Taxation Committee.

AB 1199 (Cardenas and Matthews, 2001) would have provided a sales tax exemption for clothing and footwear purchased for \$200 or less and computers and computer-related equipment purchased for \$1,000 or less during a 3-day period in August 2001. AB 1199 was held under submission in Assembly Appropriations Committee.

**Computers.** AB 2056 (Zettel, 2002) would have provided a partial sales and use tax exemption for qualified personal computer products during a 2-day period in August, starting in 2002, and continuing for the same 2-day period for each year thereafter. The bill was held under submission in Assembly Revenue and Taxation Committee.

AB 1977 (Strickland, 2002) would have provided a partial sales tax exemption for specified computer products purchased for \$2,000 or less during a 3-day period at the end of August or the beginning of September, starting in 2003, and continuing for the same 3-day period for each year thereafter. AB 1977 was held under submission in Assembly Revenue and Taxation Committee.

**All tangible personal property.** AB 1320 (Ashburn, 1999) would have provided a sales tax exemption for tangible personal property purchased for \$500 or less during the week of January 17 to January 23. This bill would have sunset on January 1, 2005. AB 1320 failed to pass from its house of origin by the deadline.

## COMMENTS

- 1. Sponsor and Purpose.** This bill is sponsored by the author is intended to provide a sales tax holiday that will help preserve California's high educational standards by helping parents buy the supplies their children need for academic success.

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2. **The May 24, 2011 amendments** (1) clarify that the exemption period is a three-day period, (2) add a repeal date of January 1, 2016, (3) define "qualified back-to-school product," and (4) specify that the proposed exemption does not apply to the Bradley-Burns Uniform Local Sales and Use Tax Law or the Transaction and Use Tax Law.
3. **Exemption may not apply to some merchandise exchanges and rain checks.** Under current law, when merchandise is returned for other merchandise, the law considers the transaction as two separate transactions: a rescission of the original sale and a separate sale of the replacement merchandise. As an example, if a customer purchases a backpack and exchanges the backpack for a messenger bag, the transaction is regarded under the law as a separate sale of the messenger bag and a rescission of the original sale of the backpack. The retailer is allowed to deduct from his or her taxable sales amount for purposes of reporting the correct amount of sales tax to the BOE, the sales price of the backpack, and is also required to include in his or her taxable sales amount, the sales price of the messenger bag. Using this example under the proposed holiday period, if the backpack is purchased during the sales tax holiday period, and is exchanged for the messenger bag *after* the holiday period, the proposed exemption would not apply to the exchange of the messenger bag since that transaction is recognized under the law as having occurred after the exempt holiday period. This may result in reporting errors by retailers and added confusion and inquiries by customers.

Another source of confusion could result from the use of rain checks. Current law also provides that a rain check issued by a retailer does not constitute a sale of tangible personal property. Therefore, if a retailer is out of stock of a particular item and issues a rain check to the customer during the holiday period, and the customer subsequently uses the rain check to purchase the out of stock item after the proposed holiday period, the exemption would not apply.
4. **The sales tax holiday could increase retailer's costs.** Creating a sales tax exemption that only lasts for four days would place an additional burden on retailers to have their cash registers programmed to tax sales on certain dates and not tax sales on other dates. This may require retailers to incur costly and frequent reprogramming of their registers to accommodate the change. Retailers would presumably be compensated for this by increased sales activity during the specified period.
5. **Exemption applies to sales tax only.** The proposed law would exempt sales of any article of clothing, footwear, school supplies, and sports equipment from the computation of the sales tax, but not the use tax. Therefore, California consumers ordering these items from out-of-state, Internet and mail order retailers, for example, would continue to remain liable for the use tax during the specified period.
6. **Partial exemptions complicate administration.** Currently, most sales and use tax exemptions are applied to the total applicable sales and use tax. However, there are currently a few partial exemptions in California law, in which only the state tax portion of the sales and use tax rate is exempted, such as sales and purchases of teleproduction equipment and farm equipment. These partial exemptions are difficult for both retailers and the BOE. They complicate return preparation and return processing. And, errors on returns attributable to these partial exemptions occur frequently, which result in additional return processing workload for the BOE.

**COST ESTIMATE**

Administrative costs would be incurred in notifying affected taxpayers, modifying tax returns, revising regulations and pamphlets, answering inquiries from industry and the public, programming changes, auditing claimed amounts, revising sales tax returns, and reviewing returns with claimed exemptions. In addition, because of the potential for a partial tax exemption, administrative costs would also be incurred in computer programming, return analysis, and return processing. An estimate of these costs is pending.

**REVENUE ESTIMATE****BACKGROUND, METHODOLOGY, AND ASSUMPTIONS**

A "qualified back-to-school product" is defined to include the following school supply products: backpacks (as specified); binders; blackboard chalk; book bags; calculators; cellophane tape; compasses; composition books; crayons; dividers; erasers; folders, as specified; geometry sets; glue, paste, or glue sticks; highlighters; index cards; lunch boxes; markers; notebooks; notepads; pencil boxes and other school supply boxes, pencils; pencil sharpeners; pens; protractors; rulers; scissors; student planners; and writing tablets.

School supplies are purchased in a variety of different types of retail establishments. The most likely places to purchase these types of items are book and stationery stores, office supply stores, and supermarkets. Based on information from the merchandise line sales compiled by the U.S. Department of Commerce, we estimate that school supplies represent about 6.3 percent of the total sales made at these stores. By applying this percentage to 2009 taxable sales for those types of stores, we estimate that purchases of school supplies amounted to \$1,633 million in 2009. Assuming a 1.4 percent annual growth, 2012 sales of school supplies is estimated to be \$1.701 billion.

While the purchase of school supplies is spread throughout the year, more of these purchases would be made just prior to the start of a new school year. We estimate that as much as 20 percent of the total year's purchases could be made during the three-day exemption period. Estimated sales of school supplies for the four-day exemption period in August of 2012 are \$340 million.

**REVENUE SUMMARY**

The revenue loss from exempting from the sales tax "back-to-school products" purchased during the three day period in August 2012 would be as follows:

| <u>Revenue Impact</u><br>(In millions) |                |
|--|----------------|
| State (5.0%)                           | \$ 17.0        |
| Fiscal Recovery (0.25%)                | .9             |
| Local Revenue (0.5%)                   | 1.7            |
| Public Safety Fund (0.5%)              | 1.7            |
| Total Revenue Loss                     | <u>\$ 21.3</u> |

|                       |                   |              |                    |
|-----------------------|-------------------|--------------|--------------------|
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